

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its own motion, seeking to investigate the use of expense caps in the earnings calculation for Nebraska universal service fund support.

Application No. NUSF-64

QWEST CORPORATION

TESTIMONY OF WAYNE CULP

February 1, 2008

1 **I. IDENTIFICATION OF WITNESS**

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3 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

4 A. My name is Wayne G. Culp. I am employed by Qwest Corporation as a Manager -
5 Finance. My business address is 1314 Douglas On The Mall, Room 1350, Omaha,
6 Nebraska 68102.

7 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

8 I have been employed by Qwest, U S WEST, or one of its predecessors for 31 years.
9 Early in my career I worked for Mountain Bell in Montana as an engineer and a data base
10 manager. In 1980 I began working on the Montana Mountain Bell financial and public
11 policy staff in Helena. I was responsible for reviewing independent telephone company
12 cost accounting studies and administering settlements and payments. I also developed
13 and supported Mountain Bell's revenue requirements for each of the five years of the
14 Commission-ordered Rural Telephone Improvement Program. I worked on financial
15 analysis on the Utah public policy staff and was the controller for Emergency Systems
16 Division of U S WEST Enterprises.

17 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

18 A. I have a Masters of Business Administration degree from the University of Utah in Salt
19 Lake City and a Bachelor of Science in Electrical Engineering from Montana State
20 University in Bozeman.

21 **Q. WHAT ARE YOUR CURRENT JOB DUTIES?**

1 A. In my current position I manage a team of analysts responsible for state regulatory
2 financial reporting and analysis for Qwest and its subsidiaries. For Nebraska I supervise
3 the preparation and submittal of state reports including the Universal Service reporting
4 that is of a financial nature.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION OR**
6 **OTHER STATE COMMISSIONS?**

7 A. Yes. In the past I have presented expert testimony for Qwest, U S WEST, and Mountain
8 Bell on subjects related to state financial issues including intrastate revenue requirements,
9 intrastate jurisdictional accounting, and accounting for the sale of exchanges. I testified
10 in South Dakota, New Mexico, North Dakota, Washington, and Wyoming concerning
11 cost of service or revenue requirement issues. Additionally, I worked with regulators on
12 a variety of financial issues in Montana, Minnesota, Nebraska, Iowa, and Utah.
13 Specifically in Nebraska, I have participated in several of the universal service
14 workshops and the initial workshop in this docket. I also testified in Application No. C-
15 2124 concerning the proper accounting treatment for the gain on the sale of exchanges.

16 **II. PURPOSE OF TESTIMONY**

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18 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

19 A. The purpose of my testimony is to offer Qwest's perspective on the issues being
20 considered by the Commission in this docket.

1 **III. IMPLEMENTATION OF EXPENSE CAPS**

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3 **Q. SHOULD THE PROPOSAL TO ESTABLISH EXPENSE CAPS CONTAIN**
4 **DIFFERENT TERMS AND CONDITIONS APPLICABLE TO RURAL AND**
5 **NON-RURAL NETCS?**

6 A. No. Both federal and state NUSF statutes require that the rules governing state USF
7 support must be competitively neutral and I believe competitive neutrality encourages
8 efficiency. Qwest has similar costs and expense drivers as other carriers in rural areas in
9 Nebraska and at the same time serves more rural lines than any other NETC. Cost may
10 vary, however. As a large company Qwest has economies of scale. It chooses to use a
11 union workforce, and it relies on call centers to process customer requests for service and
12 to dispatch repair services. Smaller companies will find other methods to provide the
13 same service. Finally, it is a matter of law that any rules or processes that are adopted
14 must be competitively neutral, and Qwest believes that implementing discriminating rules
15 for different carriers will create unfair advantages and could drive economically
16 inefficient operations.

17 **IV. USE OF THE REGRESSION MODEL**

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19 **Q. THE PROPOSAL FOR AN INITIAL EVALUATION OF ETC EXPENDITURES**
20 **CENTERS AROUND A COMPLEX REGRESSION EQUATION DEVELOPED**
21 **BY STAFF. WHAT IS THE PROPER USE OF SUCH AN EQUATION IN THE**
22 **PROCESS OF ENSURING NUSF SUPPORT IS USED FOR ITS INTENDED**
23 **PURPOSES?**

24 A. Staff has not provided access to the detailed inputs or the application of the data within
25 the regression analysis, and I offer no comment on the soundness of the application of the

1 equation. However, conceptually, no mathematical equation can definitively determine
2 whether and to what extent NUSF support is being used for its intended purposes,
3 regardless of how detailed or complex the data are.

4 At different times, different companies face different costs that vary and are difficult to
5 capture in a mathematical equation. Even within Qwest there are different needs and
6 costs. The cost to provide service in Omaha is different than the cost in Ainsworth.

7 There are many reasons for the differences including the economies of scale for urban
8 consumers, the change in consumer demand caused by competition, and the opportunity
9 to deploy new technology in the changing telecommunications environment.

10 Additionally, the costs and needs in Omaha and Ainsworth are different from one year to
11 the next. Any final determination of whether an ETC is using support properly must be
12 based on specific evidence of expenditures for a specific carrier. It is, therefore,
13 important that if the proposed regression analysis is used, it should merely be a
14 preliminary step and further analysis is necessary.

15 I am encouraged from reading the Commission's October 10 order in this docket that
16 states that the regression analysis will be used only to determine which companies
17 "would face no further scrutiny from the Commission" beyond annual audit requirements
18 already in place. I urge the Commission to clarify and expand on this statement if the
19 Commission decides to adopt the regression analysis as part of its review process of the
20 use of support from the state USF.

21 **Q. WHAT ARE YOUR OVER-RIDING HIGH LEVEL CONCERNS WITH THE**
22 **REGRESSION MODEL AND ITS APPLICATION TO EXPENSE CAPS?**

1 A. As I noted above, a mathematical equation cannot solely provide a proper substitute for
2 case-by-case examination of NETCs' expenses. As a Qwest analyst, I am concerned,
3 however, that Staff has not fully disclosed or documented the specific inputs and how
4 they are applied in regression analysis. As a result, Qwest fears that the regression
5 outputs may be misleading as to whether expenses are "high" or "low."

6 That said, Qwest provides retail and wholesale service that supports rural consumers for
7 which universal support is intended. Therefore, as much as possible, the expense level
8 needs to match and correlate with the investment, square miles served, and households
9 served for both retail and wholesale service. For Qwest that means identifying and
10 eliminating the nonregulated expense and investment in creating the regression model.
11 Additionally, as the Commission considers the regression algorithm, the Commission
12 must have proper evidence demonstrating that the regression algorithm uses the best
13 drivers to predict the range of reasonable expense outputs. Then in the future when the
14 model is applied, it is equally important for the Commission to adopt an order requiring
15 consistent application of the inputs. To give good indications of outliers it is imperative
16 that the inputs and drivers used in developing the regression are consistently applied in
17 the future execution.

18 Finally, as a matter of policy, the Commission must be extremely careful as it develops
19 and uses the regression equation. Emphasis on the regression equation could drive
20 carriers to plan expenses to satisfy an equation rather than the more direct goal of
21 efficiently providing consumers with excellent service.

1 **Q. WHAT MODEL INPUTS OR DRIVERS CAUSE THE HIGHEST RISK OF**
2 **YIELDING INACCURATE RESULTS?**

3 A. First, the regression analysis should use gross investment as an input. It appears that if the
4 Commission intends on using the NUSF-64 calculator currently posted on its web site
5 that this concern may be addressed because it uses “Plant in Service” as an input rather
6 than “Net Plant”.

7 For example, when rural cable is provided it must also be maintained; therefore,
8 increased plant investment usually indicates more maintenance cost. As an accounting
9 measure, “net investment” recognizes that gross investment is depreciated and has less
10 book value. In the practical world, however, the total or gross amount of plant or
11 investment determines the amount of maintenance cost – not the “net” book value. In
12 fact, older and more depreciated plant may require more maintenance at higher costs than
13 newer investment. Accordingly, Qwest proposes the Commission use gross investment
14 as the driver rather than net investment as the input to their regression analysis.

15 Second, two accounts, 6540 – Access Expense and 6620 – Operator and Number Service
16 Expense, do not seem to be related in a logical way to the independent variables in the
17 equation. Qwest uses Account 6540 for the Federal USF contributions which it is
18 required to pay to the FCC for interstate retail services. This cost is not associated with
19 NUSF supported services and is inconsistent with the types of cost and the cost levels of
20 most other carriers. Qwest proposes that the amount of the Company’s charges for
21 Federal USF contributions paid to the FCC should be adjusted from Account 6540
22 amounts used in the NUSF-64 regression analysis. The same application should apply
23 for operator and DA services as they do not impact providing service to rural customers.

1 Third, expenses and investment for nonregulated services should be excluded. Many
2 providers, including Qwest, have significant and growing levels of nonregulated services.
3 For Qwest, the accounting for nonregulated expense and investment follows the FCC
4 accounting safeguards in 47 CFR Parts 32 and 64 and can be easily identified for the
5 Commission. Qwest proposes that expenses and investment from nonregulated services
6 should not be included in any regression determined cap for USF support.

7 Fourth, accounting cost inputs should be consistent across all providers. All companies
8 should follow the system of accounts required in 47 CFR Parts 32 and the other rules
9 such as Parts 36, 54 and 64.

10 Additionally, Qwest does not file a Form M with the FCC or the Nebraska PSC. Instead
11 Qwest files its cost and revenue detail in the FCC's Automated Reporting Management
12 Information System (ARMIS), see <http://www.fcc.gov/wcb/eafs/>, and relies on the
13 significant reports and schedules in ARMIS for the bulk of its Nebraska annual report to
14 the PSC. Qwest proposes that companies that do not provide the Form M should provide
15 the summary account detail required by the Commission to complete the regression
16 analysis. The ARMIS Form 43-03 should contain the account detail described by the
17 Commission and clearly identifies regulated and nonregulated amounts.

18 **Q. SHOULD THE COMMISSION UPDATE THE UNDERLYING INFORMATION**
19 **PERIODICALLY? IF SO, HOW SHOULD THE INFORMATION BE**
20 **UPDATED?**

21 **A.** The regression analysis should be updated annually. Annual reporting is the most
22 universal accounting convention used for most financial and regulatory reporting

1 purposes, and it appears that the accounting detail that will be required by the
2 Commission is readily available. Therefore Qwest proposes that the data be updated
3 annually.

4 **Q. IN ITS COMMENTS, QWEST QUESTIONED WHETHER THE COMMISSION**
5 **INCLUDED THE ACCESS LINES SOLD TO COMPETITORS LEASING**
6 **UNBUNDLED NETWORK ELEMENTS. THE COMMISSION DID NOT**
7 **INCLUDE THOSE ACCESS LINES IN THE INITIAL DATA SET. SHOULD**
8 **THESE LINES BE INCLUDED GIVEN THE GOAL OF THIS PROCEEDING IS**
9 **TO INCLUDE EXPENSES APPROPRIATELY ASSOCIATED WITH**
10 **UNIVERSAL SERVICE?**

11 **A.** Qwest incurs costs to provide telecommunications networks for both its retail and its
12 wholesale customers. Qwest operates and maintains plant and investment that is resold
13 or leased to CLECs that in turn provide NUSF-supported services to high cost consumers.
14 The cost to maintain and operate the entire plant should be included and matched with the
15 appropriate count of the wholesale or resold access lines. Eliminating resold or leased
16 access lines, while including the cost, will distort the relationships within and the outputs
17 from the regression analysis. Qwest proposes that the resold or leased access lines should
18 be included in regression analysis inputs.

19 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

20 **A.** Yes.